Lump sums and compensation payments

The two Working Sheets in this Help Sheet tell you how to deal with lump sums that derive from an employment. They tell you what figures to enter in boxes 1.24 to 1.30 in the Employment Pages of your Tax Return.

This Help Sheet covers

- payments (excluding pensions) and benefits given:
  - on termination of employment
  - on a change in employment terms
  - on or after retirement or death - but only from an **unapproved** scheme. (An unapproved retirement benefits scheme is a scheme set up by your (ex) employer to provide retirement or death benefits. It does not include a scheme approved by the Inland Revenue.)
  - after termination of employment as a result of an agreement at termination
- contributions by your employer to an unapproved retirement benefits scheme.

Different rules apply to these different items and the Working Sheets direct you through them. If you are in any doubt, ask your Inland Revenue office or tax adviser.

Start with Working Sheet 2

You will not need to look at Working Sheet 1 unless a lump sum relates to an employment that involved 'foreign service'. 'Foreign service' means the time for which you were employed and for which **either**:

- you were 'not resident and ordinarily resident' in the UK, **or**
- you qualified for Foreign Earnings Deduction (FED).

(**Note**: FED was abolished from 6 April 1998, except for seafarers.) If this applies, Working Sheet 2 will direct you.

If you need more advice, ask your Inland Revenue office or tax adviser, or ask for leaflet *IR20 'Residence and non-residence'* from the Orderline.

FILLING IN THE WORKING SHEET

Completing Working Sheet 2 involves four steps.

Step 1 Enter all the lump sums, benefits, contributions and so on relevant to the year ended 5 April 2000 (regardless of whether tax has been deducted under PAYE).

Step 2 Next, the sums should be divided up so that the right rules can be applied to the different types.

Step 3 Make adjustments for the various deductions that reduce the tax to pay on the sums. You may find it useful to have your Employment Pages to hand, as you will be asked to copy figures to it as you go. However, make sure you finish all the Working Sheet boxes.

Step 4 Calculate taxable figures. **Transfer these figures to your Employment Pages.**

Working Sheet 1: foreign service

First fill in boxes G to K in Working Sheet 2.

Full exemption: box L Working Sheet 2

You get full foreign service exemption if:

- 75% of your service was foreign service, **or**
- the last 10 years were foreign service and the total service was more than 10 years, **or**
- the total service was more than 20 years and 50% was foreign service (including any 10 of the last 20 years).

If this applies to you:

- ignore the rest of this Working Sheet
- return to box L and enter the sum from box J there. Only enter in box L that sum which is from the employment in which you had 'foreign service'. Then continue filling in Working Sheet 2.

If this full exemption does not apply, you may be entitled to a foreign service reduction. See below.

.....

Foreign service reduction: box N of Working Sheet 2

If full exemption does not apply, but you have some foreign service, you still qualify for some relief.

Enter, in box A the figure from box J of Working Sheet 2 which is from the employment with foreign service.	**A**	£
	B	£ 30,000
	C box A *minus* box B	£
Enter the total service in the employment in **months**	**D**	
Enter the number of **months** of foreign service (the definition is in the column opposite) in the employment	**E**	
Box C x box E and divided by box D	**F**	£

Copy the figure in box F to box N on Working Sheet 2 on page 3, then fill in the rest of that Working Sheet starting at box M.

These notes are for guidance only, and reflect the position at the time of writing. They do not affect any rights of appeal.

continued over

Working Sheet 2

Enter in **box G** the total lump sum(s), benefits, contributions and so on due to you **before** any PAYE tax was deducted from them (following the guidelines in Step 1 overleaf). Any non-cash benefits need to be valued: the section of the booklet 480 'Expenses and Benefits' dealing with terminations, available from the Orderline, provides guidance. Do not include here any such benefits received while still an employee - see instead boxes 1.12 to 1.23 of the Employment Pages. Leave out sums for retirement benefit schemes that are:

- approved by the Inland Revenue
- statutory schemes (for example, Local Government Pension Schemes and the Principal Civil Service Pension Scheme)
- foreign government schemes.

Leave out:

- payments for counselling services provided in connection with termination of employment where they are exempt from tax; your Inland Revenue office or tax adviser can provide further information if needed
- reimbursed legal costs paid direct to your solicitor as part of a termination settlement dealing only with compensation for loss of employment.

For members of Her Majesty's forces only, also leave out:

- any terminal grant, gratuity or other lump sum paid to you under Royal Warrant, Queen's Order or Order in Council.

G £

Now divide the figure in box G into three parts.

1 Enter in **box H** any part of the sum in box G which is:

- part of the salary from employment (for example, salary due on termination and included in a lump sum)
- for a holiday entitlement
- a payment in lieu of notice (unless there was no entitlement to it in any terms of your employment or there was no custom of making such payments by the employer. For example, if any of your contractual terms allowed the employer to terminate your employment without notice if a payment was made you should include it in box H)
- a bonus - that is, an extra payment for services you gave in the employment
- any other sum or benefit made available because of an entitlement in your contract. But do not include redundancy payments and benefits (that is, payments made as compensation for the loss of a job due to a reduced need for employees in the business) provided that the contractual term or scheme refers specifically to redundancy
- compensation for changes in terms and conditions of employment (such as the removal of a benefit). If the changes are very wide ranging, box J may apply - your Inland Revenue office can advise if necessary
- expected as a result of service as an employee for example, the employer may always make this payment when someone leaves and so it is expected
- for a restrictive covenant (that is, an undertaking given which restricts your conduct, such as agreeing not to compete with your (ex) employer.)

H £

Enter this figure in box 1.27 unless it is zero

2 Enter in **box I**

- contributions made by your employer to an unapproved retirement benefits scheme, **and**
- receipts from an unapproved retirement benefits scheme (but not pensions, which belong in box 11.10 in your Tax Return). If you are not also a member of an approved scheme this sum may be free of tax. Ask your Inland Revenue office about Statement of Practice 13/91.

I £

3 Enter in box J the figure in box G, *minus* the figure in box H *minus* the figure in box I

J £

Figures in boxes K to N, and P, reduce taxable amounts in boxes I or J

Enter in **box K** any amount paid on account of disability which has already been included in box J. A 'disability' is a physical or psychological affliction and for this exemption to apply:

- the payer must have been aware of the disability, **and**
- the sum must be paid for disability only (and not, for example, for redundancy or severance), **and**
- the disability must have caused the termination or change in the employment for which the sum in box J is paid.

If so, enter the sum in box K: note that it must not exceed the sum in box J paid for disability.

If the figure in box K equals that in box J, go to box O and leave boxes L to N blank.

K £

Enter in **box L** any foreign service exemption claimed in respect of a sum included in box J. You cannot claim exemption here for any sum included anywhere else. Working Sheet 1 tells you what figure to use. If box L is the same as the sum included in box J, miss out boxes M and N and go to box O now.

L £

Box M deals with an exemption from tax for sums which you have entered in box J. Follow these rules to establish what sum to enter:

- the maximum exemption for each employment is £30,000 **but** the sum in box M must not exceed the sum in box J. For example, if you entered £12,000 in box J as a redundancy payment, the exemption in box M must also be £12,000 not £30,000
- employments with the same employer or with employers under the same or common control, must be treated as one employment. So, for example, redundancy payments from two companies in one group qualify for only **one** exemption of up to £30,000
- the exemption is available for all payments or benefits from the termination of the same employment (as defined in the previous bullet). If the termination settlement provides payments or benefits for more than one year, any unused exemption is carried forward to the next year. For example, say £20,000 of the exemption was used last year, then the remaining £10,000 is brought forward to receipts from the same settlement this year. So in this example if this year's payments or benefits (included in box J) are £4,000, you would enter £4,000 in box M. The unused balance of £6,000 would be carried forward to use against any payments or benefits from the same settlement received next year. Make a note of any balance carried forward for next year's Return.
- for employment terminations in the two years to 5 April 1998 there were special interim arrangements in force for taxing payments and benefits received after termination of employment. If you opted for those arrangements you may have used part of the exemption for that employment in those years. If so, you must deduct the sum used from £30,000 before entering a figure in box M. Your Inland Revenue office can tell you the sum if necessary.

Enter this figure in box 1.24 unless it is zero

M £

Enter in **box N** any foreign service reduction claimed. Use Working Sheet 1 to calculate the figure to go here. Consider here **only** lump sums in box J from employment with foreign service and **not** any in boxes H or I.

N £

O boxes K + L + M + N £

Box P deals with exemptions available **only** in respect of sums you have entered in box I. Exemption is available for sums:

- which arose because of an accident while an employee of the payer, **or**
- which were funded by a contribution from your employer on which you have already paid tax. For this to apply you must have been taxed on the contributions for the year they were made. Evidence of this may be required, **or**
- which arose from your own contributions, **or**
- from an overseas scheme. This exemption is only available if further tests are met; ask your Inland Revenue office about ESC 10 if this may apply.

Enter this figure in box 1.26 unless it is zero

P £

Enter this figure in box 1.28 unless it is zero

Q box I *minus* box P £

Enter this figure in box 1.29 unless it is zero

R box J *minus* box O £

Enter this figure in box 1.25 unless it is zero

S boxes K + L + N £

***Note**: where tax has been deducted from the lump sum(s), you may have already included that tax in the figure in box 1.11. If you have, make no entry in box 1.30. Otherwise, enter the amount of the tax in box 1.30.*